APPENDIX A

37 T.C. 99

TAX COURT OF THE UNITED STATES

CRAIG R. SHEAFFER and VIRGINIA D. SHEAFFER, *Petitioners*

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent.*

Docket No. 84269. Filed October 31, 1961.

In 1954 petitioner Virginia D. Sheaffer entered into a trust agreement with a bank as trustee wherein petitioner created a separate trust for each of her four children and transferred to the trustee 70,000 shares of the common stock of W. A. Sheaffer Pen Company. The trustee agreed to assume and pay all gift taxes which shall or may be assessed or become due from anyone by reason of the transfer. In 1954 and 1955 the Pen Company paid the trustee as dividends on the 70,000 shares the amounts of $140,000 and $115,500, respectively. On March 14, 1955, petitioners each filed a United States gift tax return wherein each spouse consented to have the gifts each one made during 1954 considered as having been made one-half by each spouse. The total gift taxes shown on both returns amounted to $327,307.04, which amount was paid by the trustee on March 14, 1955, partly out of dividend income and partly with borrowed funds. Petitioners filed joint income tax returns for the calendar years 1954 and 1955. The respondent, in determining the income tax deficiencies for both years, determined that the above dividends received by the trustee were taxable income to petitioners. *Held*, respondent did not err in so including the above dividends in petitioners' income.

Aaron Holman, Esq., for the petitioners.

Leo A. McLaughlin, Esq., and *John W. Holt, Esq.*, for the respondent.

OPINION

ARUNDELL, *Judge:* Respondent determined deficiencies in income tax for the calendar years 1954 and 1955 in the amounts of $125,910.80 and $84,683.81, respectively.

The only issue remaining is whether the respondent erred in determining that in the calendar years 1954 and 1955 petitioners realized income in the amounts of $140,000 and $115,500, respectively, "on the theory that such income, which was earned by the trusts created by petitioner Virginia D. Sheaffer under a Trust Agreement dated February 2, 1954, was applied by the trustee thereof as partial payment of an alleged legal obligation of the taxpayers." (Petition.)

Another issue relating to a dividend received credit under section 34 of the Internal Revenue Code of 1954 has been conceded by the respondent and effect will be given to this concession in any recomputation to be made under Rule 50.

We find the facts as stipulated and set forth only those deemed necessary in reaching our decision.

Petitioners are husband and wife residing at High Point, Fort Madison, Iowa. They filed joint Federal income tax returns for the taxable years 1954 and 1955 with the district director of internal revenue, Des Moines, Iowa.

On February 2, 1954, petitioner, Virginia D. Sheaffer (hereinafter sometimes called Virginia), entered into an agreement as settlor with Harris Trust and Savings Bank, of Chicago, Illinois, as trustee, wherein she created four separate trusts, one for the benefit of each of her four children. The agreement allocated the corpus of the trust estate to the aforesaid trusts in the proportion of 25/70, 25/70, 10/70 and 10/70, respectively.

Upon the execution of the trust agreement, Virginia assigned and delivered to the trustee certificates totaling

70,000 shares of the common stock of W. A. Sheaffer Pen Company, to be divided among the four trusts in the proportions stated above. On December 31, 1955, the trustee held those identical certificates, i.e., none having been disposed of except that the shares were deposited by the trustee as collateral security for the loan referred to later in this opinion.

Section I of the trust agreement reads as follows:

> The trustee agrees that, to the full extent of the value of the corpus of the trust estate and the income therefrom, it will assume and pay all federal and state gift taxes (including all penalties and interest thereon, if any) which shall or may be assessed or become due from any one by reason of the transfer, assignment and delivery to it of the property listed in Schedule A or by reason of the creation of the trust estate hereunder; and, notwithstanding any other provision herein, the trustee agrees to assume, and to indemnify and hold all persons whomsoever harmless against and from, any obligation or liability whatsoever which they, or any of them, shall or may have for the payment of such taxes or for the reimbursement of, or contribution to, the trustee or any person whomsoever on account of the payment of such taxes. The trustee is authorized and agrees to obtain a loan in an amount sufficient to pay all such taxes and to pledge or otherwise to apply such part or all of the corpus and income of the trust estate, and to take such other action, as shall be required or deemed advisable by the trustee in order to secure the loan. The trustee agrees to apply the proceeds of such loan in payment of such taxes.

On or about March 11, 1955, the Harris Trust and Savings Bank, the trustee of said trusts, prepared a gift tax return for Virginia with respect to the aforesaid gifts of

stock to the trusts. The said return was signed by Virginia as donor; and petitioner Craig R. Sheaffer (hereinafter sometimes called Craig), as her husband, signed the consent appearing thereon to have the gifts made by them during the calendar year considered as having been made one-half by each of them.

Pursuant to the requirements of the trust agreement, the trustee filed the gift tax return on March 14, 1955, with the district director of internal revenue, Des Moines, Iowa. The amount of gift tax shown on the return was $167,559.64. At the time that it filed the return, the trustee paid the gift tax with its own check in the aforesaid amount drawn on the trust account.

On the same date that the trustee prepared the aforesaid gift tax return for Virginia, it prepared a gift tax return for Craig with respect to the aforesaid gifts of stock to the trusts. The return was signed by Craig as donor, and Virginia, as his wife, signed the consent appearing thereon to have the gifts by them during the calendar year considered as having been made one-half by each of them. Pursuant to the requirements of the trust agreement the trustee filed the gift tax return for Craig on March 14, 1955, with the district director of internal revenue, Des Moines, Iowa. The amount of gift tax shown on the return was $159,747.40. At the time that it filed the return, the trustee paid the gift tax with its own check in the aforesaid amount drawn on the trust acount.

On or about March 7, 1955, the trustee executed and filed with the district director of internal revenue, Des Moines, Iowa, trustee's information returns with respect to the aforesaid gifts of stock to each separate trust.

The gift taxes paid by the trustee on filing the aforesaid gift tax returns in the total amount of $327,307.04, were charged to the respective trusts in the proportions of 25/70, 25/70, 10/70 and 10/70 pursuant to provisions of the trust agreement.

At the time the trustee paid the aforesaid gift taxes totaling $327,307.04, it had received income aggregating $188,607.04 for the accounts of the four trusts. Pursuant to the provisions of the trust agreement, the trustee borrowed $138,700 for the four trusts on the security of the trust assets, charging the trusts with their respective amounts thereof in the proportions stated above. The payment of the aforesaid gift taxes was thereafter made with the total of the borrowed funds and of the accumulated income then on hand.

In the gift tax return of Virginia (Schedule A), the market value of the 70,000 shares of W. A. Sheaffer Pen Company stock was reported at $24.50 per share on the date of the gift, or a total of $1,715,000. From this amount Virginia deducted the total gift taxes of $327,307.04 paid by the trustee, leaving $1,387,692.96 as the "Value at date of gift," to which was added $9,500 of other gifts made by Virginia during 1954, thus bringing the "Total gifts of donor" for 1954 up to $1,397,192.96.

In the gift tax return of Craig (Schedule A), Craig reported "Total gifts of donor" for 1954 of $6,000 to his wife Virginia.

Schedule A of both returns then continued thus:

	Virginia	Craig
(a) Total gifts of donor	1,397,192.96	$ 6,000.00
(b) Less portion [½ of (a)]	698,596.48	0
(c) Balance	698,596.48	6,000.00
(d) Gifts of spouse [item (b)]	0	698,596.48
(e) Total gifts for year	698,596.48	704,596.48
(f) Less total exclusions	4,750.00	7,750.00
(g) Total included amt. of gifts for year	693,846.48	696,846.48
(h) Deduction	0	4,570.67
(i) Total deductions	0	4,570.67
(j) Amount of net gift for year	$693,846.48	$692,275.81

On audit of the returns the respondent determined that the value of the shares on the date of the gift was $26.3672 per share or a total of $1,845,704. The resulting deficiency in tax of $27,657.24 ($14,132.35 for Virginia and $13,524.89 for Craig) plus interest of $4,824.48, making a total of $32,481.72, was paid by the trustee on February 10, 1958, and charged to the four trusts in the respective proportions stated above. In determining the deficiencies in gift tax against Virginia and Craig, the respondent followed the same pattern used by petitioners in their gift tax returns and, as a part of that pattern, deducted the total gift taxes of $354,964.28 from the total redetermined value of the shares of $1,845,704 to arrive at the redetermined "Value at date of gift" of $1,490,739.72.

In 1954 the trustee received dividends on the 70,000 shares of W. A. Sheaffer Pen Company stock in the amount of $140,000. These funds were used to purchase in 1954

U. S. Treasury notes in the amount of $136,643.14. In 1955 the trustee received dividends on the aforementioned stock in the amount of $115,500. In 1954 and 1955 the trustee received interest in the Treasury notes in the amounts of $990 and $997.46, respectively. On or about March 11, 1955, the trustee sold for $136,000 the Treasury notes purchased in 1954.

The total receipts and disbursements of the four trusts in the calendar years 1954 and 1955 were as follows:

Receipts	
Dividends on stock of W. A. Sheaffer Pen Co.	$255,500.00
Interest on U.S.A. Treasury notes	1,987.46
Proceeds of sale of U.S.A. Treasury notes	136,000.00
Proceeds of loan	202,680.00
	$596,167.46

Disbursements	
U.S.A. Treasury notes purchased	$136,643.14
Interest paid on U.S.A. Treasury notes purchased	651.76
Trustee's fees and expenses	6,508.68
1954 Federal income tax	63,981.66
Federal gift tax	327,307.04
Principal and interest payment on notes	61,075.18
	$596,167.46

In its income tax returns for 1954 and 1955 the trustee reported as taxable income all dividends received by it in the said years on the aforesaid 70,000 shares of stock of W. A. Sheaffer Pen Company as well as the interest income that it received in those years. The total Federal income tax paid by the trustee on the income so reported was $63,981.66.

The respondent in determining the instant income tax deficiencies against petitioners increased petitioners' tax-

able income as disclosed by their joint returns for 1954 and 1955 by "Dividend Income for benefit of Grantor" in the respective amounts of $140,000 and $115,500 and, in a statement attached to the deficiency notice, explained these adjustments thus:

> (a) It is determined that Virginia D. Sheaffer, as a donor, and Craig R. Sheaffer, as a beneficiary, realized income of $140,000.00 in this year [1954, and $115,500 in 1955] from Virginia D. Sheaffer Trusts which were created under a Trust Agreement dated February 2, 1954, as such income was applied by the trustee as a partial payment of a legal obligation of these taxpayers.

At the outset, it may be noted that the applicable Internal Revenue Code pertaining to the instant income tax deficiencies is the 1954 Code and the applicable Code pertaining to the gift tax is the Internal Revenue Code of 1939. See section 7851, I.R.C. 1954.[1]

Also, at the outset it may be noted that in the statement attached to the deficiency notice the respondent refers to Virginia as a donor and to Craig as a beneficiary. For the

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[1] SEC. 7851. APPLICABILITY OF REVENUE LAWS.

(a) General Rules.—Except as otherwise provided in any section of this title—

(1) Subtitle A [Income Taxes]—

(A) Chapters 1 • • • of this title shall apply only with respect to taxable years beginning after December 31, 1953, and ending after the date of enactment of this title • • •.

• • • • • •

(2) Subtitle B [Estate and Gift Taxes].—

• • • • • •

(B) Chapter 12 [Gift Tax] of this title shall apply with respect to the calendar year 1955 and all calendar years thereafter, and with respect to such years chapter 4 of the Internal Revenue Code of 1939 is hereby repealed.

purposes of this case, we think both Virginia and Craig must be considered as donors of the 70,000 shares of the Pen Company stock. Section 1000 (f), I.R.C. 1939, provides in part:

> (f) Gift of Husband or Wife to Third Party.—
>
> (1) Considered as made one-half by each.—
>
> (A) In General.—A gift made after the date of the enactment of the Revenue Act of 1948 by one spouse to any person *other than his spouse*, shall, for the purpose of this chapter, *be considered as made one-half by him and one-half by his spouse* * * *.
>
> (B) Consent of Both Spouses.—Subparagraph (A) shall be applicable only if both spouses have signified * * * their consent to the application of subparagraph (A) in the case of all such gifts made during the calendar year by either while married to the other. [Italics supplied.]

On page 1 of their respective gift tax returns for 1954, both Virginia and Craig signed the "Consent of Spouse" consenting to have the gifts made by each of them to third parties considered as having been made one-half by each. This was in accordance with section 1000 (f), *supra*. Accordingly, we will consider both Virginia and Craig as the donors of the 70,000 shares transferred to the trustee on February 2, 1954.

It is our opinion that the respondent properly determined that the dividends received by the trustee of $140,000 in 1954 and $115,500 in 1955 are taxable to petitioners in those years under section 677 of the Internal Revenue Code of

1954.[2] The trustee used those dividends for the benefit of petitioners in paying the greater part of their gift tax liability for the calendar year 1954 of $327,307.04. It is clear beyond doubt that petitioners are by statute, regulations, and Court decisions made primarily liable for the gift tax. Section 1008 (a), I.R.C. 1939, provides that "The tax imposed by this chapter shall be paid by the donor on or before the 15th day of March following the close of the calendar year." Section 86.3 of Regulations 108 provides that "the tax is a primary and personal liability of the donor." Section 1009 of the 1939 Code provides: "If the tax is not paid when due, the donee of any gift shall be personally liable for such tax to the extent of the value of such gift."[3] In *Fletcher Trust Co.* v. *Commissioner*, 141 F. 2d 36 (C.A. 7, 1944), certiorari denied 323 U.S. 711, affirming 1 T.C. 798, the court stated, in discussing sections 509 and 510 of the Revenue Act of 1932, the predecessor of sections 1008 and 1009 of the 1939 Code, that:

> The provisions of the Act to which we have referred make plain, so we think, that the liability of the donor is primary and that of the donee secondary. In other words, it is only when the former fails to pay the tax

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[2] SEC. 677. INCOME FOR BENEFIT OF GRANTOR.

(a) General Rule.—The grantor shall be treated as the owner of any portion of a trust, whether or not he is treated as such owner under section 674, whose income without the approval or consent of any adverse party is, or, in the discretion of the grantor or a non-adverse party, or both, may be—

(1) distributed to the grantor;

(2) held or accumulated for future distribution to the grantor • • •

[3] The tax here involved was due March 15, 1955 (sec. 1008 (a), I.R.C. 1939). The trustee paid the tax of $327,307.04 shown on the returns on March 14, 1955, and the deficiency of $27,657.24 on February 10, 1958. Since the original tax of $327,307.04 is greater than the income here in question of $255,500, we need not be concerned any further with the deficiency.

that it becomes the liability of the latter. This is so even though the liability of the donee may attach the next day after that on which the donor becomes liable.

In the instant case the trustee paid the gift tax shown on the returns before it became due. Actually, therefore, the donee never became "personally liable for such tax" for at the time the tax was paid, the only existing statutory liabilities for the tax were those of Virginia and Craig. Even if the tax had not been paid when due, the personal liability of the donee would only run concurrently with the continuing liability of the donor. The original primary liability is that of the donor and it continues even after the donee becomes additionally liable. In this respect it would not seem important whether the donor's original and continuing liability is satisfied before or after the donee also becomes liable for the tax. Thus, in paying the tax before or by the due date, the trustee is clearly satisfying the exclusive and statutory liability of the donor. That clear and obvious fact is dispositive of this case.

In the instant case the trust agreement specifically provided that the trustee was to pay the donor's gift tax liability. Future income of the trust estate was reserved for that purpose. The trustee did pay the gift tax of $327,307.04 shown on petitioners' returns before it became due. We think the result of this reservation and payment is to make the donors taxable under section 677, *supra*, on the funds so used in their behalf to the extent of the income of $255,500 received by the trustee. *Douglas* v. *Willcuts*, 296 U.S. 1; *Lucy A. Blumenthal*, 30 B.T.A. 591, revd. 76 F. 2d 507 (C.A. 2, 1935), but affd. 296 U.S. 552 (1935); *Clifton B. Russell*, 5 T.C. 974, petition for review dismissed, 154 F. 2d 829; *Herbert A. Loeb*, 5 T.C. 1072, affd. 159 F. 2d 549 (C.A. 7, 1947). See also *Estate of A. E. Staley, Sr.*, 47 B.T.A. 260, affd. 136 F. 2d 368 (C.A. 5, 1943), certiorari denied, 320 U.S. 786.

The Staley case was a case where the taxpayer who was the owner of 80 percent of a corporation's common stock,

transferred into trusts created for each of his five children certain common and preferred shares. On realizing that the gift tax would exceed his available cash by approximately $150,000, the taxpayer decided upon a plan to have each of the five trusts pay over to him out of trust income all such income (after paying expenses and fees) until each trust had paid him $30,000. In holding that the grantor was taxable on the $150,000 so reserved, we said (p. 265):

> The simple fact is that decedent was providing a means of securing $150,000 from the first income of the trusts, and this income he received. The fact that payment of the $150,000 was to be made out of income is indicative of decedent's retention of a right to income in that amount. See *Bettendorf* v. *Commissioner*, 49 Fed. (2d) 173. Whether we say decedent made himself a preferred beneficiary of the trusts to the extent provided, *Annie Louise Van Aken*, 35 B.T.A. 151, or that he reserved $150,000 of the income of the trusts when he made the gifts, *Michael Fay et al., Executors*, 34 B.T.A. 662, is of no particular importance in determining the fundamental question of whether or not the sum received was taxable income. * * *

We see no material difference in principle between making a gift of stock in trust with a reservation (after paying expenses and fees) of the first $150,000 of income, which the settlor intended to use to pay his gift taxes directly, as in *Staley*, and, as in the instant case, the making of a gift of stock in trust with a provision in the trust instrument that the trustee is to pay the gift tax. In both cases, income is reserved for the benefit of the donor and, under section 677, is taxable to the donor.

Petitioners contend that when the trustees paid the gift tax shown on the returns to be due, it was discharging the liability of the donees rather than that of the donor. We have previously shown herein that, under the statute, the

donor is primarily liable for the gift tax and that the donee's liability arises only if the tax is not paid when due. Here, the tax shown on the gift tax returns was paid the day before it became due so, in reality, the donees in the instant case never became liable for the tax that was paid on March 14, 1955. However, even if the tax had not been paid when due and the donees had become personally liable therefor under section 1009 of the 1939 Code, the liability of the donor would nevertheless continue until the tax was paid. The case of *Edwards* v. *Greenwald*, 217 F. 2d 632 (C.A. 5, 1954), is of no help to petitioners. In that case the trustees of certain trusts paid off certain indebtedness for which they were *primarily* liable, whereas in the instant case Congress has made the donor primarily liable for the tax, which liability continues until the tax is paid.

We sustain the respondent's determination on the authority of the cases previously mentioned. Because of the concession made by the respondent relating to a dividend received credit,

Decision will be entered under Rule 50.

APPENDIX B

UNITED STATES COURT OF APPEALS
FOR THE EIGHTH CIRCUIT.

No. 17,075

ESTATE OF CRAIG R. SHEAFFER, DECEASED, WALTER A. SHEAFFER, II, and JOHN D. SHEAFFER, EXECUTORS, and VIRGINIA D. SHEAFFER, *Petitioners*,

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent*.

On Petition for Review of a Decision of the Tax Court of the United States

[February 13, 1963]

Before SANBORN, VAN OOSTERHOUT and MATTHES, Circuit Judges.

MATTHES, Circuit Judge.

This case is here on petition to review the decision of the Tax Court which determined deficiencies in federal income taxes against petitioners for the calendar years 1954 and 1955 in the amounts of $120,008.64 and $78,352.25, respectively. The decision of the Tax Court is reported at 37 T.C. 99 (1961).

The underlying question for determination is whether for federal income tax purposes, the 1954 and 1955 income derived from the corpus of trust property and applied by the trustee toward payment of the federal gift tax on the corpus was income to the donors (settlors) of the property.[1] The pertinent facts were stipulated and so found by the Tax Court.

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[1] In this case, the applicable Internal Revenue Code pertaining to the income tax deficiencies is the 1954 Code and the applicable code pertaining to the gift tax is the 1939 Code.

Craig R. Sheaffer and Virginia D. Sheaffer, as husband and wife,[2] filed joint federal income tax returns for 1954 and 1955. On or about February 2, 1954, Virginia D. Sheaffer, as settlor, executed a trust instrument whereby she created four separate trusts for each of her four children and named Harris Trust and Savings Bank of Chicago, Illinois, as trustee. Upon execution of the trust agreement, Virginia assigned and delivered to the trustee certificates for 70,000 shares of the common stock of W. A. Sheaffer Pen Company, and on December 31, 1955, the trustee held these identical certificates.

Section 1 of the trust agreement is relevant to the litigated question and provides:

> "The trustee agrees that, to the full extent of the value of the corpus of the trust estate and the income therefrom, it will assume and pay all federal and state gift taxes (including all penalties and interest thereon, if any) which shall or may be assessed or become due from any one by reason of the transfer, assignment and delivery to it of the property listed in Schedule A or by reason of the creation of the trust estate hereunder; and, notwithstanding any other provision herein, the trustee agrees to assume, and to indemnify and hold all persons whomsoever harmless against and from, any obligation or liability whatsoever which they, or any of them, shall or may have for the payment of such taxes or for the reimbursement of, or contribution to, the trustee or any person whomsoever on acount of the payment of such taxes. The trustee is authorized and agrees to obtain a loan in an amount sufficient to pay all such taxes and to pledge or otherwise to apply such part or all of the corpus and income of the trust estate, and to take such other action, as shall be required or deemed advisable by the trustee in order to secure the loan. The trustee agrees to apply the proceeds of such loan in payment of such taxes."

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[2] Craig R. Sheaffer died while the case was under consideration by the Tax Court and Walter A. Sheaffer, II, and John D. Sheaffer, as executors, were substituted as parties petitioners.

On or about March 14, 1955, the trustee, pursuant to the trust agreement, filed separate gift tax returns for Virginia and Craig covering the above mentioned stock. Virginia's return was signed by her as donor and by her husband Craig as consenting spouse pursuant to § 1000(f), Int. Rev. Code of 1939, which permits a gift made by one spouse to "be considered as made one-half by him and one-half by his spouse." The same procedure was followed with respect to the return filed on behalf of Craig; that is, he signed as donor and Virginia as his wife signed the consent. The Tax Court determined that under § 1000(f), Int. Rev. Code of 1939, "both Virginia and Craig must be considered as donors of the 70,000 shares of the Pen Company stock," and since this determination is not disputed by either party, we shall treat both Virginia and Craig Sheaffer as the donors or grantors. The gift tax due from Virginia as shown by her return was $167,559.64, and the gift tax due from Craig as shown by his return was $159,747.40. At the time the returns were filed, March 14, 1955, the trustee paid the gift tax, $327,307.04, with its own check and charged that amount to the respective trusts in the proportions indicated in the trust agreement.

As dividends on the 70,000 shares of stock, the trustee received $140,000 in 1954 and $115,500 in 1955. The total receipts and disbursements of the four trusts in the calendar years 1954 and 1955 are shown in detail in the Tax Court's decision and need not be restated here. For our purposes, it is sufficient to observe that the total gift tax of $327,307.04 (as computed by the trustee) was paid by the trustee with trust funds on hand of $188,607.04 and with the proceeds of a loan totaling $138,700 that the trustee had obtained on the security of the assets in the trust.

Upon audit of the gift tax returns the Commissioner of Internal Revenue determined that the value of the W. A. Sheaffer Pen Company stock was greater than that shown

on the returns and thus, that there was a deficiency in the gift tax payment. This deficiency, with interest, was paid by the trustee in 1958 and is not in controversy here.

The deficiency in the income tax of petitioners for the years 1954 and 1955 was predicated by the Commissioner in the first instance and later confirmed by the Tax Court on the theory that the dividends received by the trustee in the amount of $140,000 and $115,500 for 1954 and 1955, respectively, and which were applied by the trustee toward payment of the aforesaid gift tax, constituted income to the Sheaffers.

The Commissioner's position, summarily stated, is that under the trust agreement the trustee, a non-adverse party, had the discretionary right to apply the trust income to a reduction of the grantors' liabilities; that such discretion was exercised by application of the 1954 and 1955 trust income to payment of the gift tax which was the personal and primary liability of the grantors; and that these circumstances bring this case within the provisions of § 677 of the 1954 Internal Revenue Code and justified treatment of such income as taxable to grantors.

Petitioners assert that the grantors, donee and gift assets all became liable for gift taxes at the time that the gift was made; that it cannot realistically be contended that liability of the grantors for such tax is primary and that of the donee and other secondary and tertiary. From this premise petitioners argue for application of the rule that where more than one person is responsible for a debt, payment by one of them does not give rise to income on the part of the others.[3]

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[3] Petitioners cite non-trust cases, holding that payment of an obligation by one party having a financial interest in a transaction does not create income to another also financially interested, e.g. *Tucker* v. *Commissioner*, 8 Cir., 226 F. 2d 177 (1955); *Ruben* v. *Commissioner*, 8 Cir., 97 F. 2d 926 (1938).

At the outset we once again observe that the Tax Court's findings are presumptively correct—the burden rests upon petitioners to show that the findings upon which the Tax Court based its decision are clearly erroneous—and unless the findings are against the clear weight of the evidence or are induced by an erroneous view of the law, we are not, as a reviewing court, at liberty to disturb such findings on appeal. *Sachs* v. *Commissioner*, 8 Cir., 277 F. 2d 879, 881 (1960), cert. denied, 364 U.S. 833 (1960); *Estate of Craig M. Smith* v. *Commissioner*, 8 Cir., . . . F. 2d . . . , opinion filed Feb. 12, 1963. Here, as in *Estate of Craig M. Smith* v. *Commissioner*, supra, the facts were stipulated, but this circumstance "does not make this issue any less factual in nature. The Tax Court is entitled to draw whatever inferences and conclusions it deems reasonable from such facts." *Boehm* v. *Commissioner*, 326 U.S. 287, 293 (1945); *Estate of Craig M. Smith* v. *Commissioner*, supra, . . . at . . . .

Under § 1000 of the applicable 1939 Internal Revenue Code, a tax is imposed upon transfers of property, by gift, subject to certain exclusions and deductions set forth in other sections which are not pertinent here. Section 1006 requires a donor to file a gift tax return "on or before the 15th day of March following the close of the calendar year," and § 1008 imposes an obligation upon the donor to pay the gift tax on or before this same 15th day of March. Under § 1009, "The tax . . . shall be a lien upon all gifts made during the calendar year, for ten years from the time the gifts are made," and "*. . . the tax is not paid when due, the donee of any gift shall be personally liable for* such tax to the extent of the value of such gift." (Emphasis supplied). Also relevant is § 86.3 of Treasury Regulations 108 (1939 Code) which provides that:

> "The [gift] tax is not imposed upon the receipt of the property by the donee, nor is it necessarily determined by the measure of enrichment resulting to the

donee from the transfer, nor is it conditioned upon ability to identify the donee at the time of the transfer. *On the contrary, the tax is a primary and personal liability of the donor*, is an excise upon his act of making the transfer, is measured by the value of the property passing from the donor, and attaches regardless of the fact that the identify of the donee may not then be known or ascertainable." (Emphasis supplied).

An examination of the controlling gift tax statutes and the cases interpreting them leads us to the inescapable conclusion that the liability for payment of the tax is in the first instance that of the donor, and the donee does not become liable unless the donor fails to make payment of the tax by the 15th day of March following the close of the calendar year. See *Mississippi Valley Trust Co.* v. *Commissioner*, 8 Cir., 147 F. 2d 186 (1945), and *Fletcher Trust Co.* v. *Commissioner*, 7 Cir., 141 F. 2d 36 (1944), cert. denied, 323 U.S. 711 (1944). Since the tax in this case was paid before the 15th day of March, we need not concern ourselves with the possible ramifications of a situation where payment of the tax was made at a time when both the donor and the donee were independently liable for the tax. Indeed, the primary obligation here was upon the donors; Virginia and Craig Sheaffer, and no additional liability, secondary or otherwise, ever arose since the gift tax shown on the returns was paid before it became due on March 15, 1955.

Remaining for our determination is the question whether the trust income applied by the trustee, pursuant to its express discretionary power, to the payment of the primary gift tax obligation of the grantors, was income constructively received by the grantors and therefore subject to the income tax in controversy. Here, the parties differ in their views as to the applicable statutes. Section 677 of the Internal Revenue Code of 1954 provides in pertinent part:

> "The grantor shall be treated as the owner of any portion of a trust * * * whose income without the approval or consent of any adverse party is, or, in the discretion of the grantor or a non-adverse party, or both, may be—
>
> "(1) distributed to the grantor;"

Section 1.677(a)-1(d) of the Treasury Regulations on income tax (1954 Code) provides:

> "Under Section 677 a grantor is, in general, treated as owner of a portion of a trust whose income is, or in the discretion of the grantor or a non-adverse party, or both, may be applied in discharge of a legal obligation of the grantor."

Petitioners contend that § 677 has no relevance and that we should look only to § 61 of the 1954 Code which provides, in effect, that gross income means all income from whatever source derived, including but not limited to fifteen specifically designated items.

We agree with the Commissioner that § 677, supra, must first be applied in determining whether as a result of the transaction petitioners derived income which is within the ambit of § 61, supra. We are of the view that, inasmuch as the income from the trust was applied by a non-adverse party (the trustee) in discharge of the grantors' primary obligation to pay the gift tax, the grantors must be treated as owners of that portion of the trust for income tax purposes. To us this holding is in accordance with the explicit provision of § 677, supra, and the applicable regulations and is consistent with judicial decisions which in our view are analogous in principle.

In *Douglas* v. *Willcutts*, 296 U.S. 1 (1935), a husband created a trust which became part of a divorce decree and which provided for full settlement of alimony in favor of his divorced wife. The Supreme Court, applying the forerunners of the statutes here involved, held that income

from the trust was income taxable to the husband since it was used in discharge of his general obligation to support.

Helvering v. *Blumenthal*, 296 U.S. 552 (1935), reversing 76 F. 2d 507 (1935), furnishes additional support for the Commissioner's position. There, a settlor irrevocably transferred approximately $300,000 worth of stock in trust upon condition that the trust pay out of dividends received on the stock, a $33,000 demand note of the settlor held by a bank and secured by pledge of the stock which was the subject of the trust. Relying in part upon the bank's custom of selling the stock before seeking to enforce payment by the obligor, the Second Circuit held that the settlor was not liable for income tax on the dividends, stating:

> "The effect of transferring this stock, subject to the debt, was to make the stock the primary fund to meet the obligation and to place the petitioner [settlor] in the relation of surety only. Petitioner [settlor] was not enriched in any way by the payment of the note," 76 F. 2d at 508.

In a per curiam opinion and on the authority of *Douglas* v. *Willcutts*, *supra*, 296 U.S. 1, the Supreme Court reversed the Second Circuit.

We also regard *Staley* v. *Commissioner*, 5 Cir., 136 F. 2d 368 (1943), cert. denied, 320 U.S. 786 (1943), as persuasive authority against the contentions asserted by petitioners. In *Staley*, the taxpayer created five trusts by gift, expressly reserving the first $30,000.00 of income from each trust. This amount, or a total of $150,000, was paid to the taxpayer. Although the trust agreements did not explicitly provide the purpose for which the income was being reserved, it is apparent that the purpose of the reservation was to provide the amount necessary to discharge the taxpayer's gift tax obligation and that the taxpayer actually used the amount reserved for that purpose. Indeed,

the Fifth Circuit, in holding the amount reserved as taxable income of the donors, stated that the gift:

> "* * * was intended to be, and actually was, a gift of the entire corpus and of all the income except an amount necessary to assist in paying the gift taxes. Expressed differently, it was an outright transfer for no consideration; but with a reservation to the donor of a portion of the income." 136 F. 2d 369, 370.

See also, *Helvering* v. *Stuart*, 317 U.S. 154 (1942), modified 317 U.S. 602 (1942), and *Loeb* v. *Commissioner*, 7 Cir., 159 F. 2d 549 (1946).

Petitioners would, in effect, have us ignore the basic fact that the transfer in this case was made in *trust*. The cases cited by petitioners that involved trusts, such as *Edwards* v. *Greenwald*, 5 Cir., 217 F. 2d 632 (1954) and *David Keith*, 45 B.T.A. 644 (1941), are factually distinguishable. We have also accorded due consideration to *Estate of Morgan*, 37 T.C. 981 (1962), decided by the Tax Court since its decision in this case. We do not regard *Morgan* as controlling or dispositive of the issues presented herein.[4]

In summary, the donors here transferred property as a gift in trust in 1954; became primarily liable for the payment of the federal gift tax; gave the trustee discretionary power to use trust income to satisfy this obligation; had their gift tax obligation discharged by March 15, 1955, partially with the 1954 and 1955 trust income, before any other party became liable for the gift tax payment; and thus, within the meaning of the law, became the owners of a portion of the trust for income tax purposes.

Although the factual circumstances and the statutes involved in *Griffiths* v. *Commissioner*, 308 U.S. 355 (1939), were entirely different from those in the instant case, we

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[4] We are advised that the Commissioner has appealed the decision in the *Morgan* case to the Court of Appeals for the Sixth Circuit.

believe that some of the language used by the Supreme Court in that opinion is particularly apropos here.

> "We cannot too often reiterate that 'taxation is not so much concerned with the refinements of title as it is with actual command over the property taxed—the actual benefit for which the tax is paid.' • • • And it makes no difference that such 'command' may be exercised through specific retention of legal title or the creation of a new equitable but controlled interest, or the maintenance of effective benefit through the interpostion of a subservient agency. • • • 'A given result at the end of a straight path' • • • 'is not made a different result because reached by following a devious path.' Legislative words are not inert, and derive vitality from the obvious purposes at which they are aimed, • • •. Taxes cannot be escaped 'by anticipatory arrangements and contracts however skillfully devised . . . by which the fruits are attributed to a different tree from that on which they grew.'" 308 U.S. at 357, 358.

What the trustee received as trust income and applied to payment of the gift tax, the Sheaffers in reality constructively received, and on that the petitioners must be taxed.

The decision of the Tax Court is

Affirmed.

A true copy.

Attest:

Clerk, U. S. Court of Appeals, Eighth Circuit.

APPENDIX C

Judgment

UNITED STATES COURT OF APPEALS
FOR THE EIGHTH CIRCUIT

No. 17,075. September Term, 1962.

ESTATE OF CRAIG R. SHEAFFER, Deceased, WALTER A. SHEAFFER, II, and JOHN D. SHEAFFER, Executors, and VIRGINIA D. SHEAFFER, *Petitioners*,

vs.

COMMISSIONER OF INTERNAL REVENUE.

On Petition for Review of Decision of The Tax Court of the United States.

This cause came on to be heard on the petition to review the decision of The Tax Court of the United States entered December 13th, 1961, determining that there are deficiencies in the income taxes against petitioners for the calendar years 1954 and 1955, and was argued by counsel.

On Consideration Whereof, It is now here Ordered and Adjudged by this Court that the decision of The Tax Court in this cause be, and the same is hereby, affirmed.

And it is further Ordered by this Court that the petition to review in this cause be, and it is hereby, dismissed.

February 13, 1963.

Order entered on Opinion:

Clerk, U. S. Court of Appeals,
Eighth Circuit.

APPENDIX D

Statutes and Regulations Involved

The Internal Revenue Code of 1939, 53 Stat. 1, is applicable to the gift tax in this case. The Internal Revenue Code of 1954, 68A Stat. 1, is applicable to the income tax in this case.

The relevant provisions of the Internal Revenue Code of 1939 are as follows:

"Sec. 1000. Imposition of Tax

"(a) For the calendar year 1940 and each calendar year thereafter a tax, computed as provided in section 1001, shall be imposed upon the transfer during such calendar year by any individual, resident or nonresident, of property by gift.

* * * * * *

"Sec. 1008. Payment of Tax

"(a) Time of Payment.—The tax imposed by this chapter shall be paid by the donor on or before the 15th day of March following the close of the calendar year.

* * * * *

"Sec. 1009. Lien for Tax

"The tax imposed by this chapter shall be a lien upon all gifts made during the calendar year, for ten years from the time the gifts are made. If the tax is not paid when due, the donee of any gift shall be personally liable for such tax to the extent of the value of such gift. Any part of the property comprised in the gift sold by the donee to a bona fide purchaser for an adequate and full consideration in money or money's worth shall be divested of the lien herein imposed and the lien, to the extent of the value of such gift, shall attach to all the property of the donee, (including after-acquired property) except any part sold to a bona fide

purchaser for an adequate and full consideration in money or money's worth. If the Commissioner is satisfied that the tax liability has been fully discharged or provided for, he may, under regulations prescribed by him with the approval of the Secretary, issue his certificate, releasing any or all of the property from the lien herein imposed.

The relevant provisions of the Internal Revenue Code of 1954 are as follows:

SEC. 61. GROSS INCOME DEFINED.

(a) GENERAL DEFINITION.—Except as otherwise provided in this subtitle, gross income means all income from whatever source derived, including (but not limited to) the following items:

(1) Compensation for services, including fees, commissions, and similar items;

(2) Gross income derived from business;

(3) Gains derived from dealings in property;

(4) Interest;

(5) Rents;

(6) Royalties;

(7) Dividends;

(8) Alimony and separate maintenance payments;

(9) Annuities;

(10) Income from life insurance and endowment contracts;

(11) Pensions;

(12) Income from discharge of indebtedness;

(13) Distributive share of partnership gross income;

(14) Income in respect of a decedent; and

(15) Income from an interest in an estate or trust.

SEC. 677. INCOME FOR BENEFIT OF GRANTOR.

(a) GENERAL RULE.—The grantor shall be treated as the owner of any portion of a trust, whether or not he is treated as such owner under section 674, whose income without the approval or consent of any adverse party is, or, in the discretion of the grantor or a nonadverse party, or both, may be—

(1) distributed to the grantor;

(2) held or accumulated for future distribution to the grantor; or

(3) applied to the payment of premiums on policies of insurance on the life of the grantor (except policies of insurance irrevocably payable for a purpose specified in section 170 (c) (relating to definition of charitable contributions)).

This subsection shall not apply to a power the exercise of which can only affect the beneficial enjoyment of the income for a period commencing after the expiration of a period such that the grantor would not be treated as the owner under section 673 if the power were a reversionary interest; but the grantor may be treated as the owner after the expiration of the period unless the power is relinquished.

The relevant regulations are as follows:

Treasury Regulations 108 (1939 Code)

"Sec. 86.1. IMPOSITION OF TAX

"The statute imposes no tax upon property, but subjects to tax transfers of property by gift.

* * * * * * * * * *

"Sec. 86.2. TRANSFERS REACHED

"(a) In general.—. . . Various statutory provisions, which exempt bonds, notes, bills and certificates of the indebtedness of the Federal Government or its agencies and the interest thereon from taxation, are not applicable to the gift tax since this tax is an excise tax on the transfer, and is not a tax on the subject of the gift.

"Sec. 86.3. CESSATION OF DONOR'S DOMINION AND CONTROL

"The tax is not imposed upon the receipt of the property by the donee, nor is it necessarily determined by the measure of enrichment resulting to the donee from the transfer, nor is it conditioned upon ability to identify the donee at the time of the transfer. On the contrary, the tax is a primary and personal liability of the donor, is an excise upon his act of making the transfer, is measured by the value of the property passing from the donor, and attaches regardless of the fact that the identity of the donee may not be known or ascertainable.

* * * * * * * * * *

"Sec. 86.34. DONOR LIABLE FOR TAX

"The statute provides that the donor shall pay the tax . . . As to the personal liability of the donee, see section 86.35, and as to that of the executor or administrator, see section 86.70.

* * * * * * * * * *

"Sec. 86.35. LIEN FOR TAX

"A lien attaches upon all gifts made during the calendar year for the amount of the tax imposed upon the gifts made

during such year. The lien extends for a period of 10 years from the time the gifts were made, unless the tax is sooner paid. If the tax is not paid when due, the donee of any gift becomes personally liable for the tax to the extent of the value of his gift."

* * * * * * * * * * *

Treasury Income Tax Regulations (1954 Code)

"Reg. § 1.677(a)-1. INCOME FOR BENEFIT OF GRANTOR; GENERAL RULE.

(a) Section 677 deals with situations in which a grantor of a trust is treated as the owner of a portion of the trust because he has retained an interest in the income from that portion. See section 671 and §§ 1.671-2 and 1.671-3 for rules for treatment of items of income, deduction, and credit when a person is treated as the owner of all or only a portion of a trust.

"(b) Under section 677, the grantor is treated in any taxable year as the owner of a portion of a trust (whether or not he is treated as an owner under section 674) of which the income for the taxable year or for a period not coming within the exception described in paragraph (e) of this section is, or in the discretion of the grantor or a nonadverse party, or both, (without the approval or consent of any adverse party) may be—

"(1) Distributed to the grantor;

"(2) Held or accumulated for future distribution to the grantor; or

"(3) Applied to the payment of premiums on policies of insurance on the life of the grantor, except policies of insurance irrevocably payable for a charitable purpose specified in section 170(c).

* * * * * * * * * * *

"(d) Under section 677 a grantor is, in general treated as owner of a portion of a trust whose income is, or in the

discretion of the grantor or a nonadverse party, or both may be, applied in discharge of a legal obligation of the grantor. However, see § 1.677(b)-1 for special rules for trusts whose income may not be applied for the discharge of any legal obligation of the grantor other than the support or maintenance of a beneficiary whom the grantor is legally obligated to support."

APPENDIX E

ESTATE OF ANNETTE S. MORGAN, Deceased, WILLIAM N. MORGAN, Executor v. COMMISSIONER.

Docket No. 88298. 37 TC 981, No. 95.

Filed February 21, 1962.

* * * * * * * * * * * *

Howard M. Kohn, Esq., and C. W. Landefeld, Esq., for the petitioner.

Buckley D. Sowards, Esq., for the respondent.

FAY, Judge: The Commissioner determined deficiencies in income tax of the decedent for the years 1957 and 1958 in the amounts of $13,238.26 and $26,686.82, respectively. The only issue for decision is whether certain income of trusts created by the decedent is taxable to her.

FINDINGS OF FACT

Most of the facts are stipulated and are found as stipulated.

The decedent resided during the taxable years in question in the City of Cleveland, Ohio. She filed timely Federal income tax returns for these years with the district director of internal revenue at Cleveland.

On October 18, 1955, the decedent created certain irrevocable trusts in favor of her issue consisting of 41,600 shares of stock in The Morgan Engineering Company, hereinafter referred to as the Morgan stock. The stock at that time had a value of approximately $1,000,000. The decedent's son, William H. Morgan, and her attorney, Robert S. Pflueger, were made trustees.

The trust agreement imposed upon the trustees the duty of paying the gift taxes incurred in connection with the gift and contained the following language relative thereto:

> The parties hereto expressly agree that the trustees shall pay any and all gift and/or other taxes occasioned

by the transfer herein, and that the stock is transferred subject to the trustee's obligation to pay all such taxes. The trustees shall make all necessary arrangements for and attend to the payment of all said taxes, and may raise funds for such purpose by selling a portion of the transferred stock and/or by borrowing, the decision to sell stock and/or to borrow to be made in accordance with the sole discretion of the trustees. In the event the trustees decide to borrow money to pay said taxes, they are hereby authorized to borrow money from any source and pledge any part or all of the assets herein transferred, and to repay such borrowings using for such purpose any funds in their possession.

The trust instrument also contained the following language with regard to holdings of the Morgan stock by the trust:

> The settlor requests the trustees, although no duty is imposed on them in this regard, to retain as an investment of the trusts created by this instrument the common stock of the Morgan Engineering Company originally placed in the trusts hereunder, and the common stock or other securities of any concern which shall succeed to the whole or a substantial part of the assets or business of the Morgan Engineering Company, even though such an amount of securities of one company may not be considered suitable as an investment by trustees. Furthermore, if at any time there are trust funds to be invested, the settlor requests the trustees, although no duty is imposed on them in this regard, to purchase, if available, and retain as an investment of the trusts created hereunder the common stock of The Morgan Engineering Company and the common stock or other securities of any concern which shall succeed to the whole or a substantial part of the assets or business of The Morgan Engineering Company.

This language was included to protect the trustees from any charge of negligence which might arise from their continued holding of the Morgan stock, which stock was not listed on any stock exchange.

The decedent incurred a Federal gift tax in the amount of $186,664.86 for the year 1955 by reason of the transfer in trust. This gift tax was calculated by using as the amount of the gift the value of the stock given, less the amount that would be required to pay the Federal gift tax on the transfer. The decedent filed a gift tax return with the district director of internal revenue at Cleveland, Ohio, reflecting a gift tax of $186,664.86. On or about April 16, 1956, William H. Morgan, acting as trustee, arranged for a loan from The Philadelphia National Bank in the same amount as the gift tax determined to be due. The loan was made to the trustees who signed a note which was guaranteed by William H. Morgan, personally. The 41,600 shares of Morgan stock were pledged as security for the loan. The decedent had no contact with the bank in connection with the arrangement or payment of this loan and was not liable for its payment. In 1956 the trustees paid the gift tax with the proceeds of the loan. The decision to obtain the money to pay the gift tax by borrowing was made by the trustees, and the decedent took no part in making such decision.

Payments were made on the loan by the trustees from the dividends on the Morgan stock. In 1957 the trustees paid the bank $8,770.32 in interest on the loan and repaid $21,664.86 of the principal. In 1958 they paid $7,318.95 in interest and repaid $40,000 of the principal.

The Commissioner determined that the amounts paid to the bank with respect to the loan in 1957 and 1958 should be included in the income of the decedent.

The decedent received no benefit from the fact that the money to pay her gift tax was obtained by borrowing rather than by selling a part of the trust corpus.

OPINION

The respondent contends that the payments made on the loan obtained to pay the decedent's gift tax were in substance payments of the decedent's legal obligation and are therefore taxable to her under section 677(a) of the Internal Revenue Code of 1954.[1]

This Court has recently held that income of a trust used to pay the settlor's gift tax liability is taxable to the settlor. *Craig R. Sheaffer* [Dec. 25,f00], 37 T. C.—(October 31, 1961). However, in the present case the trustees had paid the gift tax of the settlor in 1956, a year prior to the taxable years before the Court. The parties have stipulated that the amount of the gift tax equalled the amount paid. Therefore, the trustees' discretion to use income of the trust to pay the decedent's gift tax was extinguished in 1956. It is not argued that the trustees could have used income from the trusts for the benefit of the decedent in

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[1] SEC. 677. INCOME FOR BENEFIT OF GRANTOR.

(a) General Rule.—The grantor shall be treated as the owner of any portion of a trust, whether or not he is treated as such owner under section 674, whose income without the approval or consent of any adverse party is, or in the discretion of the grantor or a nonadverse party, may be—

(1) distributed to the grantor;

(2) held or accumulated for future distribution to the grantor; or

(3) applied to the payment of premiums on policies of insurance on the life of the grantor (except policies of insurance irrevocably payable for a purpose specified in section 170(c) (relating to definition of charitable contributions)).

This subsection shall not apply to a power the exercise of which can only affect the beneficial enjoyment of the income for a period commencing after the expiration of a period such that the grantor would not be treated as the owner under section 673 if the power were a reversionary interest; but the grantor may be treated as the owner after the expiration of the period unless the power is relinquished.

any manner after 1956 unless repayment of the sums borrowed by the trustees may be considered such a payment.

The respondent argues that repayment of this loan does constitute payment by the trust of the decedent's legal obligation because the substance of the transaction is that the income of the trust res was used to pay the decedent's gift tax. In support of this contention the respondent cites *Clifton B. Russell* [Dec. 14,797], 5 T. C. 974 (1945), appeal dismissed 154 F. 2d 829 (C. A. 1, 1946). In the *Russell* case the settlor established an irrevocable trust in certain stock which he held outright and in his equity in other stock which was pledged for his personal debt of $25,000. The trustee was authorized to pay the debt for which this stock was pledged. The trustee borrowed $20,000 from the settlor and used this sum, together with $5,000 of income of the trust, to discharge the debt in 1940. The trustee made payments on the loan from the settlor in 1940 and 1941 out of the income of the trust. This Court held the substance of the transaction was that the income of the trust was used to pay the personal obligation of the settlor and that this could have been done without the consent of an adverse party. Therefore, the amount of the payments made to the settlor on the loan was held taxable to him. That case is distinguishable from the present case. In *Russell* the loan was made between related parties—the settlor and the trustee. In the present case the loan was an arm's length transaction with an independent party—the bank, and the settlor took no part in the transaction. Further, in *Russell* the income of the trust was paid to the settlor in satisfaction of his loan. In the present case the decedent's interest in the property of the trust terminated immediately upon the payment of the gift tax.

Section 677(a) of the Internal Revenue Code of 1954, *supra*, clearly evidences a Congressional intent that a settlor of a trust, in order to avoid tax on the income of the trust property, must receive no benefit from the income of the property without the consent of an "adverse party." Fur-

thermore, it is clear that we should not allow the taxpayer to accomplish indirectly what Congress has prohibited. On the surface this transaction appears to be but an indirect method for diverting the income of the trust property to the decedent. It appears that income of the trust property was anticipated by obtaining the loan, the proceeds of which were given to the decedent. The loan was then repaid from the income of the trust as it was realized.

Upon analysis, however, this illusion disappears. Surely had the decedent sold a sufficient amount of the Morgan stock to pay the gift tax and given the remainder to the trust, she would not be subject to tax on any part of the trust income. The result would be the same if the stock had been given to the trustees and they had then sold a portion to pay the tax, at least in years after the gift tax was paid. Did the decedent then receive any monetary benefit from the method of which the trustees chose to discharge the trust obligation to pay the gift tax? Her gift tax obligation was paid when due and that is the sole benefit she would have received no matter what method had been chosen by the trustees to obtain funds for this purpose. The manner of obtaining the money was chosen independently by the trustees who were authorized to select whatever method they deemed advisable. Of course, the fact that the trustees chose to obtain money by borrowing and then repaying the loan from income means that the trust retained more corpus and less income. This however, did not benefit the decedent because she retained no interest in the trust and could not recover the corpus. Therefore, since the decedent received no benefit from the fact that the trustees borrowed to discharge her gift tax obligation and repaid the loan from trust income, she cannot be held to have constructively received the income used to repay the loan.

This case, therefore, is controlled by our decision in *David Keith* [Dec. 12,157], 45 B. T. A. 644 (1941), acq. 1942-1 *C. B.* 10, a case which arose under section 167 of the Reve-

nue Acts of 1936 and 1938, which section was a predecessor of section 677(a) of the 1954 Code. In that case, which involved a trust established in 1926, the trustees had been authorized to sell property and/or to borrow money to pay certain debts of one of the settlors. They acquired the funds to pay the debts by both selling property and borrowing. By the end of 1930 both the debts of the settlor and the debts which the trustees incurred to pay them had been discharged. In 1931 and each year thereafter the trustees accumulated income in a sinking fund pursuant to the trust instrument to replace that portion of corpus that had been used to pay the settlor's debts. In holding the accumulated income not taxable to the settlor, we said:

> Whatever may have been said in 1926-1930 as to the propriety of attributing to petitioner the trust income used to discharge his debts, there is no theory upon which the income of succeeding years may be attributed to him. It was not subject to his control or demand and was not used for his benefit to discharge any of his obligations. His obligations had been paid in 1930 and no continuing obligation was left upon him. Thereafter, except as to the distributable shares, the trust income was taxable to the trust.

The same considerations apply in the present case.

Reviewed by the Court.

Decision will be entered for the petitioner.

TIETJENS, Judge, dissenting: The gift tax was the primary obligation of the settlor. Had the income of the trust been used directly to pay the gift tax, such payment would have been taxable income to the settlor. *Craig R. Sheaffer* [Dec. 25,100], 37 T. C.—(No. 13). Here the trustees took a roundabout method. They first borrowed money with which they paid the gift tax and then repaid the loan from trust income. It seems to me that the substance of the transactions is the same in both cases, i.e., the liability of

the settlor is discharged by income from the trust. In either case the settlor should be taxed on the trust income. *Clifton B. Russell* [Dec. 14,797], 5 T. C. 974.

TURNER and RAUM, Judges, agree with this dissent.

* * * * * * * * * *

COMMISSIONER OF INTERNAL REVENUE, *Petitioner*,

v.

ESTATE OF ANNETTE S. MORGAN, Deceased, WILLIAM H. MORGAN, Executor, *Respondent*.

U.S. Court of Appeals, Sixth Circuit, No. 15,099, Apr. 10, 1963.

37 TC 981 (Opinion by FAY, J.) affirmed. Years 1957-1958. Decision for taxpayer.

Carolyn R. Just, Atty.; On brief: Louis F. Oberdorfer, Asst. Atty. Gen., Lee A. Jackson, Robert N. Anderson, Attys., Dept. of Justice, Wash. 25, D.C., for Petitioner.

Howard M. Kohn; On brief: C. W. Landefeld; Of counsel: Grossman, Schlesinger and Carter. 1401 The East Ohio Bldg., Cleveland 14, Ohio, Attys. for Respondent.

ORDER

Before MCALLISTER and O'SULLIVAN, Circuit Judges, and WILLIAM E. MILLER, District Judge.

This cause coming on to be heard upon the petition for review of the decision of the Tax Court of the United States, and the court having considered the briefs, oral argument of counsel, and the entire record,

Now, therefore, it is Ordered, Adjudged and Decreed that the decision of the Tax Court be and is hereby affirmed on its Findings of Fact and Opinion, reported at 37 T.C. 981.